IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 933

THE WESTERN UNION TELEGRAPH COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

FRANCIS R. STARK,
Attorney for Petitioner,
Office & P. O. Address,
60 Hudson Street,
Borough of Manhattan,
New York City 13, N. Y.

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The short argument for the Government is based entirely on the assumption that the payments by the lessee to the stockholders of the lessors were dividends. It is said that the agreement was "to pay rent in the form of dividends" and that "in effect the taxpayers declared dividends"; that "distributions of dividends by a corporation without any provision for the payment of annual income taxes make the recipients distributees."

The trouble with this argument is that the legal effect of the lease is to be determined by the law of New York, and that by that law the payments are not dividends. The word "dividends" is not used in our leases; the agreements are to pay rent; but even where such leases provide that the rent will be paid "as dividends" or "in the form of dividends," the New York courts hold that the payments are not dividends, but that the recipients are third-party beneficiaries of a contract to pay these sums to them absolutely and at all events, regardless whether their cor-

poration subsequently contracts debts or not. As was said by one of the New York courts in a case considered by the lower court when it reached its former conclusion, and of which the lower court was reminded during the argument of this appeal:

> "It is apparent that the stockholders are to receive, pursuant to the lease, proportionate shares of the rent payments. 'Dividends as rent' are the words of the lease. A payment cannot be both, for the two things are essentially different. *Dividends come from earnings. The rent is not dependent on earnings.* The lease provides that the payments to stockholders shall take the form of dividends. The provisions of the agreement do not change the character of the payment. The payment was still to be of rent." *Bowers* v. *Interborough Rapid Transit Co.*, 121 Misc. 250, 253 (1923).

This was the view ultimately approved by the New York court of appeals.

In *Pennsylvania Steel Company* v. *New York City Railway Co.*, 198 F. 721, 762 (1912), referred to in our petition, the circuit court of appeals had before it, as a question of New York law, the precise question involved in this case, namely, whether the rent under a lease of this character must be paid to the lessor's stockholders or to the lessor's receiver. The legal effect of the transaction under New York law being plain, the court unanimously held that the rent must continue to be paid to the stockholders. As this court well said on May 15, 1944, in *Huddleston* v. *Dwyer:* "* * * the considered determination of questions of State law by intermediate Federal appellate courts is ordinarily accepted by this court. When we are called upon to decide them, the expression of the views of the judges of those courts, who are familiar with the intricacies and trends of local law and practice, if not indispensable, is at least a highly desirable and important aid to our determination of State law questions."

It is perfectly obvious that if under the State law payments must be made periodically to the stockholders of a

corporation in receivership, as against the claim of the receiver, such payments cannot be dividends. No court could permit dividends to be paid under such circumstances. The New York law plainly permits an arrangement of this kind, whereby a corporation, while solvent, and having no reason to expect that it will ever be insolvent, divests itself of the property rights in future rents and assures the payment of such rents to its stockholders as against any unexpected creditors who may afterwards turn up. There is no principle of Federal law which authorizes a Federal court to say that such an arrangement, sanctioned by the State law and actually made, is invalid. Apart from its priority, the Government has no better claim to these rents than any other creditor. Other creditors have none. A person lending money to the lessor after this lease would have no right to collect his debt out of the rents. He would know when he lent the money that the rents would never be the debtor's property. Why should the Government with a tax claim be better off than a purchaser for value?

The *Pelzer* case referred to in the Government's brief (p. 9), like the *Joliet* case, involved tax liability, not tax collection, and the intent of Congress was all that mattered: the legislative history showed that it was intended that the exemptions should be uniform. When it comes to the collection of taxes, whatever its intent, Congress cannot take A's property to pay B's tax, and whether the property is A's or B's is determined by local law.

The judgment in the *Morris* and *Essex* case referred to (p. 9) was not a final judgment, and it was no doubt proper to deny certiorari for that reason without consideration of the merits.

Respectfully submitted,

FRANCIS R. STARK,
Attorney for Petitioner,
60 Hudson Street,
New York 13, New York.